IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

Supreme Court, U.S.
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Docket No.

WALTER HOLYK, KENNETH H. DARKE and RICHARD H. CLAYTON,

71 - 347

Petitioners,

-against-

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

---

To the Honorable Warren E. Burger, Chief Justice, and the Honorable Associate Justices of the Supreme Court of the United States:

Your petitioners Walter Holyk, Kenneth H. Darke, and Richard H. Clayton pray that a writ of certiorari issue to the United States Court of Appeals for the Second Circuit for a review of the judgment entered against petitioners, among others, in Securities and Exchange Commission v. Texas Gulf Sulphur Company et al., on June 10, 1971.

## OPINIONS BELOW

The opinion and judgment of the United States District Court, Southern District of New York (Bonsal, J.) in favor of petitioners, except as to certain transactions of Mr. Clayton is reported at 258 F. Supp. 262 and at Appendix, p. 1a.* The opinion of Judge Waterman for the Second Circuit Court of Appeals, en banc, concurred in, in whole or in part, by six other judges of that Court, reversing the judgment of the District Court and remanding the case for further proceedings, and the dissenting opinion of Judge Moore, concurred in by Chief Judge Lumbard, are reported at 401 F. 2d 833, 970 and at Appendix, pp. 66a and 129a.

*Reference in this form are to the separately bound appendix filed by Orison S. Marden, Esq., on behalf of Petitioners Texas Gulf Sulphur Company, Fogarty, Mollison, Stephens and Kline.

The opinion on remand of the District Court, (Bonsal, J.) is reported at 312 F. Supp. 77, (1970) and at Appendix, p. 175a. Judge Waterman's opinion for the Second Circuit Court of Appeals, concurred in by Chief Judge Friendly and Judge Hays, which opinion is not yet officially reported, appears at Appendix p. 220a.

## JURISDICTION

The judgment of the Court of Appeals was entered on June 10, 1971. The statutory provision conferring jurisdiction on this Court is found at 62 Stat. 928, 28 U.S.C. 1254 (1).

## QUESTIONS PRESENTED

1. Whether, within the meaning of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, information possessed by an insider is "material":

> (a) where it would be of interest to a speculator and, if disclosed, might affect the value of the corporation's security in any degree?
>
> or
>
> (b) where a reasonable man would attach importance to it, and, if disclosed, might affect the value of the corporation's security in a significant degree?

2. Whether it was error for the Court of Appeals to reject findings of the District Court, based on the "virtually uncontradicted testimony" of expert witnesses, as to the insignificance to a reasonable investor of a single exploratory drill hole to a company with 10,000,000 outstanding shares of stock, and to substitute its own findings as to the results of that single hole?

3. Whether it was error to grant restitution as an ancillary remedy for which no provision is made under Section 21(e) of the Securities Exchange Act of 1934?

4. Whether the restitutionary relief granted was an assessment of a penalty which the Court was not empowered to levy?

5. Whether the granting of a substantive relief in a prophylactic proceeding violated petitioners' rights under the due process clause of the Fifth Amendment and their rights to jury trials under the Sixth and Seventh Amendments?

6. Whether the order of restitution requiring Mr. Darke to restore to TGS profits made by his tippees can be sustained absent any legal basis?

7. Whether the District Court abused its discretion in enjoining Mr. Clayton in the absence of any finding that there was a reasonable likelihood that he would violate the Act in the future?

## CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

Constitution of the United States, Amendments VI and VII appear at p. 1 of the Addendum to this petition.

48 Stat. 891, 900; 15 U.S.C. Sections 78j(b), 78u(e) are set forth at Appendix B, pp 235a and 236a.

17 C.F.R. Sections 240.10b-5 and 240.12b-2(j) are set forth at pp. 238a and 239a, Appendix B.

## STATEMENT OF THE CASE

### A. THE CHARGE AGAINST MESSRS. HOLYK, DARKE AND CLAYTON

Respondent filed its complaint in the United States District Court for the Southern District of New York on April 19, 1965, charging petitioners and eleven others with violations of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78) (the "Act") and of Rule 10b-5 promulgated thereunder. Respondent sought an injunction under Section 21(e) of the Act and additional relief. Jurisdiction of the District Court was invoked under Section 27.

The charges arise from a mineral exploration program begun by Texas Gulf Sulphur Company ("Texas Gulf" or "TGS") in Canada in 1957. In the course of that program an exploratory hole was drilled

near Timmins, Ontario in November of 1963 in an area denominated Kidd 55. Respondent claimed that eleven of the individual defendants "having knowledge and information of material facts concerning the result of * * * Texas Gulf's drilling * * * which facts were not generally known to the investing public" either purchased shares of Texas Gulf stock or recommended their purchases to others.

B. FACTS REGARDING PETITIONERS HOLYK, DARKE AND CLAYTON

The uncontroverted facts are that Messrs. Holyk, Darke and Clayton purchased shares or calls on shares of Texas Gulf stock between November 12, 1963 and April 9, 1964. Mr. Darke had also advised others to purchase Texas Gulf stock during this period and purchases were allegedly made pursuant to his advice. The inforamtion known by Messrs. Holyk, Darke and Clayton during this period is not in dispute. It is the "materiality" of this information which is the crux of this case.

All the information known was contained in a core visually examined on November 12, 1963 by Messrs. Holyk and Darke, Texas Gulf giologists. This core resulted from the drilling on November 8, 1963 of an exploratory hole on property referred to as Kidd 55. This initial visual examination indicated a very favorable mineral content, which was later

confirmed when the core was assayed by the Texas Gulf laboratory. Except for the results of the chemical assay, no other knowledge of the possible value of the drilled area was available.

Although laboratory results proved favorable, experts for both sides, as the trial court aptly said, "agreed that one drill core does not establish an ore body, much less a mine." Indeed, "Defendants' experts unanimously concluded that there is no way even to estimate the probabilities that one drill core will lead to the discovery of an ore body." 258 F. Supp. at 282, and at p. 29a Appendix A.

On March 31, 1964 Texas Gulf commenced an intensive drilling program in the area of Kidd 55. Existence of a mine was established on April 15, 1964.

C. THE DECISION BELOW

1. The First District Court Opinion

The District Court held that the drilled core information known by Messrs. Holyk, Darke and Clayton when they purchased Texas Gulf stock prior to April 9, 1964 was not material information. As Judge Bonsul said:

> "When considered in relation to the far-flung business of TGS at the time, it cannot be said that the drilling results of K-55-1 and K-55-3 constituted material information, the

> disclosure of which would have had a substantial impact on the market price of TGS's 10,000,000 outstanding shares." (29a)
>
> "The most that can be said of the individual defendants' knowledge after the drilling of K-55-1 is that they had 'hopes, perhaps with some reason,' that it would lead to a mine. James Blackstone Mem. Lib. Ass'n v. Gulf M.& O.R.Co., 264 F. 2d 445, 450 (7th Cir. 1959). The results of K-55-1 were too 'remote' when considered in light of the size of TGS, the scope of its activities, and the number of its outstanding shares, to have had any significant impact on the market, i.e., to be deemed material. List v. Fashion Park, Inc., supra." (30a).

Accordingly, purchases made by Messrs. Holyk, Darke and Clayton prior to April 9, 1971, when, as Judge Bonsal said "there was real evidence that a body of commercially mineable ore might exist" (28a,29a), were held not to be in violation of the Act. A purchase made by Mr. Clayton after this date was deemed violative of the Act.

2. First Court of Appeals Opinion

The Court of Appeals, reversing the District Court and holding that the core information known prior to April 9, 1964 was material, remanded the case for application of the appropriate remedies. (118a).

In reaching its decision the Court of Appeals expanded the facts and ignored the expert testimony in the record. As the dissenting judges noted, the majority substituted their own geological conclusions by stating that the initial drill core indicated a "more than marginal" possibility of the existence of a mine of "vast magnitude" (89a). The Court of Appeals then lowered the threshold of materiality to a new level by asserting that "material" facts are any "which may affect the desire of investors to buy, sell or hold the company's securities" (88a), defining "investors" to include "the speculators and chartists of Wall and Bay Streets" (87a), and concluding that the results of the first drill hole, if disclosed, "may" have affected the desires of such persons and "might" have affected stock prices.

### 3. Second District Court Opinion

On remand the District Court found that Mr. Holyk could not have anticipated the extension of "materiality" to cover his acts and refused to issue an injunction p. 90 (196a). Nonetheless, it ordered him to pay TGS the sum of $35,663.47, representing the difference between his purchase price for 550 shares and calls on 1200 shares and their market price on April 17, 1964 (208a).

On remand, Mr. Darke was ordered to pay Texas Gulf $41,794.92 for his purchases but he was not enjoined because he was no

longer employed by TGS (204a). Mr. Darke, who was held to have advised others to purchase TGS stock (94a), was also ordered to pay TGS $48,404.58, representing profits purportedly made by three such persons (207a).

On remand, Mr. Clayton was ordered to pay $20,010.56 to TGS and was also enjoined from making purchases or sales of TGS securities on the basis of material undisclosed information, despite any finding that there was a reasonable likelihood of such actions (209a, 197a).

All of the above ordered payments, which bear interest at the rate of 6% per annum from April 17, 1964, are to be paid to TGS. Such sums are to be held by Texas Gulf in an interest-bearing escrow account subject to such disposition as the court might direct. Any undisposed monies would become the property of TGS (203a).

4. The Second Court of Appeals Decision

The second appeal to the Court of Appeals was restricted to issues concerning appropriateness of remedies adapted by the District Court. The Court of Appeals held that the Securities and Exchange Commission ("SEC") may seek other than injunctive relief in an action commenced pursuant to Section 21(e) of the Act provided such relief is remedial and not a penalty assessment (227a). The Court of Appeals also held that the District Court did not abuse its discretion in issuing an injunction with respect to Mr. Clayton (226a).

## REASONS FOR ALLOWANCE OF THE WRIT

1. The Court of Appeals has decided questions of federal substantive law under the securities laws, which are of great importance and wide application to corporate personnel and the public generally. In particular, the Court of Appeals has created tests of "materiality" in the context of the Act which are unworkable, have created widespread confusion in the business community and which conflict with the SEC's own longstanding regulations and with standards adopted by the Seventh Circuit and by the Second Circuit itself in previous decisions.

2. The Court of Appeals has departed from the accepted and usual course of judicial proceeding by overturning and ignoring finds of fact of the District Court contrary to Rule 52(a) of the Federal Rules of Civil Procedure.

3 The Court of Appeals has, in conflict with a decision of the Ninth Circuit, ordered ancillary relief which goes beyond statutory authority and the exercise of federal equity powers as defined by this Court and is violative of petitioners constitutional rights.

## ARGUMENT I

### THE COURT OF APPEALS ERRED IN REVERSING THE DISTRICT COURT'S DECISION THAT THE UNDISCLOSED INFORMATION POSSESSED BY PETITIONERS WAS NOT MATERIAL AND ESTABLISHING A NEW TEST FOR DETERMINING MATERIALITY*

Petitioners liability is predicated on whether the preliminary drill core information they possessed was "material" within the meaning of Rule 10b-5 of the Act. The District Court held that the information was not material. By a divided court the Court of Appeals held otherwise. To reach its decision the Court of Appeals came to a different conclusion regarding the facts and lowered the threshold of materiality by replacing reasonable reflection with mere speculation and the probability of market impact with a may-be. In so doing it created a standard of materiality not only at variance with prior cases and SEC regulations, but a standard of hindsight evaluation providing the corporate insider with no reasonable guidance.

Both courts said that material information is that 'which in reasonable and objective contemplation might affect the value of the corporation's stock or securities ..."List v. Fashion Park, Inc., 340 F 2d 457, 462 (2d Cir.); the contemplator being the well established reasonable man or prudent investor. List v.

* The issues discussed under this argument only concern the first opinions of the District Court and Court of Appeals.

Fashion Park, Inc. Id. This definition is essentially the same as the SEC's which defines material information as "those matters as to which an average prudent investor ought reasonably to be informed before buying or selling ..." Rule 12b-2 (j) (17 C.F.R. Section 240 12b-2(j) (239a). The standard used by the courts and the SEC has been the investment judgment of a reasonable man.

To avoid the strict application of that standard and yet stay within the List doctrine, the Court of Appeals simply expanded the scope of the reasonable man. In saying that "speculators and chartists of Wall and Bay Streets are also 'reasonable' investors ...", the Court reduced the standard to the investment judgment of the speculative trader to whom any information would be material (87a). Within this altered definition, any information could be deemed material if hindsight evaluation could find someone who thought it so.

The District Court realized this problem when it noted a second requirement - information is not material merely because it would be of interest to a speculator, it must also be such that, if disclosed, it would be "reasonably certain to have a substantial effect on the market price of the security" (29a). Within this parameter the District Court held that the results of the drilled hole :

> "were too 'remote' when considered in light of the size of TGS, the scope of its activities, and the number of its outstanding shares, to have had any

> significant impact on the market, i.e., to be deemed material. List v. Fashion Park, Inc., supra." (30a)

Although the Court of Appeals also seemingly recognized the necessity of showing a substantial or significant market impact (86a), it ignored this requirement holding that the drilled core results were material because they "might well have affected the price of RGS stock ..." (89a). The Court thereby reduced the required market impact from substantial or significant to "maybe any". When coupled with its "definition" of a reasonable man, the Court of Appeals' application of the market impact test expanded the concept of materiality far beyond previous limits.

A survey of the cases concerning insider transactions reveal the test of materiality has consistently been whether the undisclosed information would be important to a reasonable man in making his investment decision and whether that information, if disclosed, would have a significant effect on the value of the security involved.*

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* Taylor v. Janigan 212 F Supp. 794 (D.Mass 1962), modified and aff'd. sub nom. Janigan v. Taylor 344 F 2d 781 (1st Cir.1965); cert. denied, 382 U.S.879 (1965); Reed v. Riddle Airlines, 266 F 2d 314, 315 (5th Cir. 1959); Baumel v. Rosen, 283 F. Supp. 128, 141 (D.Md. 1968); Ross v. Licht, 263 F. Supp. 395 (S.D.N.Y.1966) appeal dismissed, 367 F. 2d 658 (2d Cir. 1966); Speed v. Transamerica Corp. 99 F. Supp. 808 (D. Del. 1951);

This test should not now be discarded for a standard which determines information material if it may be of interest to a speculator and might affect market value. If, as the Court of Appeals suggests, any degree of interest and impact, no matter how slight, is sufficient to render a fact material, no corporate employee investing in his company's stock would be free from doubt as to a future determination of Section 10 (b) liability. Due to the often harsh results of the Rule's application corporate insiders must have a more definite and realistic standard to guide their conduct.

## II

## THE COURT OF APPEALS ERRED IN DISREGARDING F. R. C. P. Rule 52 (a) BY ARRIVING AT FACTUAL CONCLUSIONS DIAMETRICALLY OPPOSED TO THE DISTRICT COURT'S

The Court of Appeals, by concluding that the results of the first hole constituted "material information", did not give the District Court findings the consideration and weight required by law. To reach their decision the majority ignored and overturned findings of fact by the trial judge, who based his appraisal upon the

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Footnote P.14-continued
Kardon v. National Gypsum Company 83 F. Supp. 613, 614 (E.D. Pa. 1949); Ward La France Truck Corp. 13 SEC 373 (1943); Mills v. Electric Auto-Lite Co. 396 U.S. 375, 384 (1970)

testimony of eleven expert witnesses and the study of numerous geological and geophysical exhibits and charts. As pointed out by the dissenters, the majority, in disregard of F.R. C.P. Rule 52(a), chose "to reject the trial court's finding as to the results of the first drill core, K-55-1, and to substitute their own expertise in the mining engineering field * * *"(135a). The District Court credited the "virtually uncontradicted testimony" of the experts (135a) to the effect that "one drill core does not establish an ore body, much less a mine" and that "there is no way even to estimate the probabilities that one drill core will lead to the discovery of an ore body". In contrast, the majority of the Court of Appeals determined that the first hole showed the "possibility which surely was more than marginal of the existence of a mine of * * * vast magnitude * * *" (89a). This contrary conclusion was reached despite the Court's own statement that the "cleraly erroneous" rule was not applicable (89a).

The Court of Appeals in reaching this conclusion never referred to the distinguished experts called by defendants and credited by the District Judge, instead it relied heavily upon the deposition testimony of a Canadian penny stock speculator to support its geological and investment conclusions (90a). Certainly what is releveant to a speculator willing to place small sums on many penny stocks is not necessarily material to an investor. This distinction was acknow-

ledged by the District Court's conclusuion that "from an investment point of view, no significance could be attached to the results of a single drill hole" (30a). The Court of Appeals should be corrected in summarily dismissing the District Court's findings in this manner and ignoring the basic principles of appellate jurisdiction repeatedly stated by this Court (see,e.g., Graver Tank & Mfg. Co. Inc.v. Linde Air Prods. Co., 339 U.S. 605, 609-10 (1950).

## III

## THE ACT DOES NOT AUTHORIZE THE RESTITUTION OF PROFITS IN AN SEC ENFORCEMENT PROCEEDING NOR IS THIS REMEDY ESSENTIAL TO EFFECTUATE THE PURPOSES OF THE ACT

The question squarely presented on this appeal is whether the SEC, in an enforcement proceeding, can obtain relief other than the injunctive relief expressly provided in Section 21 (e) of the Act. The Court of Appeals approved the District Court's order requiring Messrs. Holyk, Darke and Clayton to make payments to TGS of $35,663.47, $90,289.50 and $20,101.56,respectively. No provision of the Act authorizes the granting of such an order. Section 21(e), pursuant to which the SEC commenced this action, only provides for injunctive relief.*

* Apparently no other relief was contemplated by Congress. S.Rep.792,73d Cong.,2d Sess., 1934,p.22; H.R.1383,73d Cong.,2d sess., 1934, p.27.

This section reads:

> "Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may bring an action . . . to enjoin such acts or practices . . ."(15 U.S.C.Section 78u(e)(236a).

In justifying payment orders, both Courts relied on the general equity powers conferred upon district courts in Section 27. This Section may authorize a district court to exercise its general equity powers to grant ancillary relief necessary to enforce an injunction which by statute the SEC was empowered to obtain. But nowhere in the legislative history of the Act is there any indication that Congress, in enforcement proceedings, authorized the creation of ancillary remedies unconnected with an injunction. Nor were any decisions in SEC enforcement actions cited to justify this created remedy. The only pertinent case cited to support the District Court's action was Mitchell v. DeMario Jewelry, 361 U.S. 288 (1960).*

*Reliance was also had on United States v. Moore, 340 U.S. 616 (1951) and Porter v. Warner Holding Co., 328 U.S. 395 (1946). Moore concerned Section 206(b) of the Housing and Rent Act of 1947 which was identical to Section 205(e) of the Emergency Price Control Act considered in Porter. In approving an order of

In Mitchell v. DeMario Jewelry, 361 U.S. 288 (1960), this Court approved a payment order, not expressly authorized by statute, on the ground that such order was required to effectuate the purposes of the statute. Mitchell, involved an action by the Secretary of Labor under Section 17 of the Fair Labor Standards Act of 1938, 29 U.S.C. Section 217 (hereinafter "Labor Act"), on behalf of certain employees to recover lost wages. This Court said at pages 292 and 293 that the purpose of the Labor Act was to protect employees by having the Secretary of Labor bring actions on behalf of employees to redress wrongs perpetrated by employers and to recover for the employees lost compensation. If it were otherwise, the Court said, employees would not complain to the Secretary of Labor of violations of the Act for fear of dismissal or economic retribution. Recovery of damages for employees was thus considered as vital to the Secretary of Labor for the effective administration of the Labor Act.

The reasons compelling resort to general equity powers to effectuate the purposes of the Labor Act are not in evidence here. A damage award, while essential to the administration of the Labor Act, is not essential to the SEC's administration of the Act. The Secretary of Labor brings

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Footnote Page 18 - Continued
repayment of rent overcharges, the Moore Court emphasized its reliance on the statutory provision providing for "other orders" in addition to injunctive orders. The Court explained that general equity power can be utilized to fashion the appropriate order once the making of the order itself is authorized by statute.

the action on behalf of the injured employee, while the SEC sues on its own behalf. The Secretary of Labor would not get the cooperation of the employee, on whose behalf he sues, unless he could assure the employee that he would not sustain a financial loss. As is apparent from the litigation involving TGS because of this case, the SEC needs no such cooperation from allegedly injured parties. Lastly, the damages recovered by the Secretary of Labor are paid directly to the injured employee on whose behalf the action was brought. There is no such close connection to the parties purportedly injured by petitioners' acts.

When a court goes beyond a statute to create a remedy the justification should be that the new remedy as in Mitchell, is not only effective but is required to effectuate the purposes of the statute, and not as here, merely because it appears to further the statute's purposes. There is no doubt that restitution of profits is not necessary to achieve the purposes of the Act. Moreover, ordering an employee to pay huge sums made by tippees will probably prove an ineffective bromide. Few, if any employees, will be able to pay the judgments and tippees will be left free to enjoy their gains. This is the type of result which obtains when the SEC and the court join hands to avoid working within the framework of the Act.

IV

THE ORDERING OF PAYMENTS BY PETITIONERS TO TGS CONSTITUTES THE IMPOSITION OF PENALTIES

A court of equity is not empowered to make penalty assessments. Beck v. Securities Exchange Commission, 430 F. 2d 673 (6th Cir. 1970); United States v. Parkinson, 135 F. Supp. 208, aff'd 240 F. 2d 918 (9th Cir. 1956). As the Court said in Parkinson:

> "Anything which savors of a penalty should not be permitted unless Congress has expressly so provided, since the spirit of equity abhors such punitive measures." 240 F. 2d at 922

The payments required to be made here are penalties within the meaning of that term as defined in United States v. Chouteau, 102 U.S. 603, 611 (1880) wherein the Court said:"The term 'penalty' involves the idea of punishment, and its character is not changed by the mode in which it is inflicted. . ." In the instant case the punitive nature of the District Court's judgment is most apparent when we consider the payment Mr. Darke is ordered to make to TGS. A portion of that payment, to wit: $48,404.58 (plus interest from 1964 at 6%)represents profits purportedly made by third parties - money which Darke never received either directly or indirectly. The amount of the payment is staggering. The basis for arriving at it is without precedent.

The Court of Appeals, at least as regards Mr. Darke, impliedly recognized the punitive nature of the payment order by saying, "admittedly more of a hardship is imposed" (229a) on Mr. Darke in connection with paying profits realized by tippees. We submit that this payment order is a good example of a "penalty" as that term was defined by this Court in Chouteau.

## V

## THE GRANTING OF THE RELIEF HEREIN VIOLATED THE CONSTITUTIONAL RIGHTS OF MESSRS. HOLYK, DARKE AND CLAYTON AND THE DUE PROCESS CONCEPT OF FAIRNESS

The decisions below deprive petitioners of their constitutional rights as contained in the Fifth, Sixth and Seventh Amendments. We submit that procedural requirements of due process are not satisfied when non-prophylactic relief is granted in a prophylactic proceeding. In this prophylactic proceeding only the slightest burden of proof had to be borne by the SEC. (Ans. Brief of SEC Feb. 1967 40-48.) A heavier burden of proof is required for a money award in a civil proceeding and an even heavier burden in a criminal proceeding. If this Court agrees that the payment orders are penalties, then it is the latter burden which should have been borne by the SEC.

If the action were for money damages for violating Section 10(b), petitioners would have been entitled to a jury trial. Richland v. Crandall, 262 F. Supp. 538 (S.D.N.Y.1967). This right they have been effectively denied by the Court's damage award in violation of the Seventh Amendment. Rachal v. Hill, 435 F. 2d 59 (5th Cir. 1970). The nature of the remedy fashioned by the Court is punitive, yet in a criminal proceeding under the Sixth Amendment, petitioners would have been entitled to a trial by jury.

The petitioners' Fifth Amendment rights have also been abridged. That Amendment has been held to require that:

> "***a fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed. To make the warning fair, so far as possible, the line should be clear." McBoyle v. United States, 283 U.S.25, 27 (1931) (Holmes, J.).

This Court has also held that an administrative body must frame its rules so "that the ordinary person can know how to avoid an unlawful course of action." M. Kraus & Bros.,Inc. v. United States, 327 U.S. 614, 626 (1946). Rule 10b-5 and its prior interpretations gave no clear warning that the conduct of petitioners herein would be violative of the Act.

VI

THERE IS NO LEGAL BASIS FOR THE ORDER OF RESTITUTION BY MR. DARKE OF PROFITS MADE BY HIS TIPPEES

Under the guise of restitution, Mr. Darke has been ordered to account for profits of $48,404.58 made by three other people. Equitable remedies are elastic but they too have limits beyond which they cannot be stretched. There can be no "restitution" in the absence of receipt or retention of benefits. See, e.g. Greenwood County v. Duke Power Co., 107 F. 2d 484 (4th Cir. 1939); Restatement, Restitution Section 1. There is no record proof that Mr. Darke ever received any benefits from his tippees.

The most that could be found in this case is that Mr. Darke recommended TGS stock at a time when he possessed confidential information. While making a recommendation in such circumstances would apparently constitute, if the decision of the Court of Appeals is sustained, a violation of Rule 10b-5, it is hardly fair to order Mr. Darke, a Canadian citizen, who was not an officer of TGS and who received no benefit from these purchases by others, to pay out of his own pocket the "profits" supposedly made by third persons. This is especially so when it is considered that prior to the institution of this action, no such possible liability had even been predicted.

If Mr. Darke violated the Act in passing confidential information to subsequent purchasers, adequate penal provisions are contained in the Act for penalizing him. Resort to these provisions should be had by the SEC before other provisions of the Act are distorted beyond recognition to achieve the same result.

## VII

## THE DISTRICT COURT ABUSED ITS DISCRETION IN GRANTING THE INJUNCTION AGAINST PETITIONER CLAYTON

We submit that the District Court abused its discretion in enjoining Mr. Clayton "from engaging in the purchase or sale of Texas Gulf Sulphur Company securities on the basis of undisclosed material information relating to Texas Gulf Sulphur acquired by ... reason of any relationship with Texas Gulf Sulphur Comapny (216a).

Unless a reasonable likelihood of future violations can be shown, injunctive relief should not be granted where the violations sought to be enjoined have ceased. SEC v. Pearson, 426 F. 2d 1339 (10th Cir. 1970) The record is barren of any facts to show that there is a reasonable likelihood that Mr. Clayton may violate the Act.

The facts concerning Mr. Clayton and Mr. Darke are almost identical, yet the Court enjoined one and not the other. As regards Mr. Darke the Court said:

> "In considering the remedy of injunction, it is noted that defendant Darke is a Canadian living in Canada. He is no longer in the employ of TGS, and hence no longer privy to any material inside information with respect to its activities. The material undisclosed information possessed by Darke when he made his purchases and recommended TGS securities to others was disclosed in April, 1964 press release announcing TGS's discovery. The SEC seeks injunctions only with respect to trading in TGS securities on the basis of TGS material undisclosed information. Since Darke no longer has the opportunity, no useful purpose would be served by the issuance of an injunction..." 312 F. Supp. at p. 90.

The same facts obtain as to Mr. Clayton; he is a resident of Canada, no longer employed by TGS, and no longer privy to material inside information. Moreover, there is no showing that he committed any violation of the Act since April 15, 1964.

The District Court, in enjoining Mr. Clayton, and the Court of Appeals, in approving the injunction, appear to have disregarded the "reasonable likelihood" test. Mr. Clayton was enjoined because

he purchased 200 TGS shares with knowledge of the mineral discovery. There was no showing, however, that he knew his purchase violated the Act. This single purchase by Mr. Clayton does not establish that there is a "reasonable likelihood" that he will violate the Act in the future. If he did have a propensity to violate the Act, it certainly should have evidenced itself in the last seven years.

## CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

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Respectfully submitted,

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## Appendix C

### Constitutional Provisions, Statutes and Rules Involved

### Sixth Amendment to the Constitution of the United States

In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining Witnesses in his favor, and to have the Assistance of Counsel for his defense.

### Seventh Amendment to the Constitution of the United States

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.